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October 6, 2011

**VIA E-FILING**

Jocelyn Boyd, Esquire  
Chief Clerk and Administrator  
South Carolina Public Service Commission  
101 Executive Center Drive  
Columbia, SC 29210

RE: Application of Carolina Water Service, Inc. for adjustment of Rates and Charges and  
Modification of Certain Terms and Conditions for the Provision of Water and Sewer  
Service

DOCKET NO.: 2011-47-WS

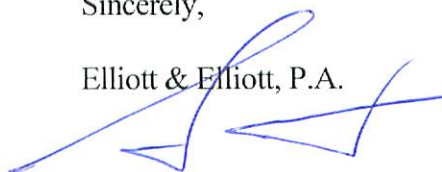
Dear Ms. Boyd:

Enclosed please find a Proposed Order submitted on behalf of Carolina Water in the above-captioned docket which I would ask you to file. By copy of this letter we are serving all parties of record.

If you or counsel has questions, please feel free to contact me.

Sincerely,

Elliott & Elliott, P.A.



Scott Elliott

SE/jcl

Enclosures

cc: All Parties of Record w/enc.

BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA  
DOCKET NO. 2011-47-W/S - ORDER NO. 2011-\_\_\_\_  
OCTOBER \_\_\_\_, 2011

IN RE:	Application of Carolina Water Service, Inc.	)	ORDER APPROVING
	for adjustment of rates and charges and	)	RATES AND CHARGES
	modification of certain terms and	)	
	conditions for the provision of water and	)	
	sewer service	)	

**I. INTRODUCTION**

This matter is before the Public Service Commission of South Carolina ("Commission") on the Application of Carolina Water Service, Inc. ("Carolina Water", "CWS" or "Company") for approval of a new schedule of rates and charges and modifications to certain terms and conditions for the provision of water and sewer services for its customers in South Carolina. Carolina Water filed its Application on April 15, 2011, pursuant to S.C. Code Ann. § 58-5-240 and 26 S.C. Code Ann. Regs. RR. 103-503 (1976), 103-703, 103-512.4.A and 103-712.4.A (1976).

By correspondence, the Commission's Docketing Department instructed Carolina Water to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the area affected by Carolina Water's Application and to mail copies of the Notice of Filing to all customers affected by the proposed rates and charges and modifications. The Notice of Filing indicated the nature of the Application and advised all interested parties desiring to participate in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. Carolina Water filed affidavits

showing that it had complied with the Docketing Department's instructions.

Petitions to Intervene were subsequently filed on behalf of the Forty Love Point Homeowners' Association ("Forty Love") and Midlands Utility, Incorporated ("Midlands"). The Commission received letters of protest from two hundred fifty-eight (258) Carolina Water customers. The South Carolina Office of Regulatory Staff ("ORS"), a party of record pursuant to S.C. Code Ann. § 58-4-10(B), made on-site investigations of Carolina Water' facilities, audited Carolina Water' books and records, issued data requests, and gathered other detailed information concerning Carolina Water' operations.

The Commission held three separate public hearings in Lexington, York and Richland counties for the purpose of allowing Carolina Water's customers to present their views regarding the Application.<sup>1</sup> Thereafter, on September 7, 2011, at 10:30 a.m., an evidentiary hearing was convened before the Commission in its offices in Columbia with the Honorable John E. Howard presiding. Carolina Water was represented at the hearing by Charles L. A. Terreni, Esquire and Scott Elliott, Esquire. Charles H. Cook, Esquire, represented Midlands. Laura P. Valtorta, Esquire represented Forty Love. Nanette S. Edwards, Esquire, and Jeffrey M. Nelson, Esquire, represented the ORS. The Commission also permitted public witnesses to testify at the hearing on September 7, 2011.

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<sup>1</sup> These hearings were held July 13, 2011, in Lexington, August 4, 2011, in Lake Wylie, and September 7, 2011 at the offices of the Public Service Commission in Columbia, SC. Pursuant to directions of the Commission's Docketing Department, notice of these hearings was given to affected customers by the Company as reflected in an affidavit filed by the Company.

The Company presented the direct and/or rebuttal testimony of six (6) witnesses, all employed by its parent company, Utilities, Inc. and assigned in various capacities to Carolina Water: Lisa Sparrow, President and Chief Executive Officer, Patrick Flynn, Regional Director; Bob Gilroy, Regional Manager.; Steven M. Lubertozzi, Executive Director of Regulatory Accounting & Affairs; Mac Mitchell, Regional Manager;; Karen Sasic, Director of Customer Care f, Kirsten Weeks, Manager of Regulatory Accounting. The Company also presented the testimony of an expert witness on rate of return, Pauline M. Ahern, CRRA, Principal of AUS Consultants.

Forty Love presented the direct testimony of Frank Rutkowski and Kim Nowell, residents of the Forty Love Point Neighborhood. Also, Forty Love presented the surrebuttal testimony of Nancy Williamson, resident of the Forty Love Point Neighborhood. Midlands presented the direct testimony of Keith G. Parnell. By stipulation of the parties, ORS submitted into the record the direct and surrebuttal testimony of its employees Willie J. Morgan, P.E., Program Manager for its Water and Wastewater Department; Dawn M. Hipp, Director of the Telecommunications, Transportation, Water and Wastewater Department; Sharon G. Scott, Senior Manager for Rate Cases; and Dr. Douglas H. Carlisle, Jr., Economist. The evidentiary hearing was completed on September 8, 2011.

In considering the Application of Carolina Water, the Commission must consider competing interests to arrive at just and reasonable rates. These competing interests are those of the ratepayer and those of the utility, which has the right to earn a fair return. *S.C. Cable Television Ass'n v. Public Serv. Comm'n*, 313 S.C. 48, 437 S.E.2d 38 (1993). Rate regulation has two aspects: control of the rate level (earnings) and control of the rate structure (prices). Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 171. As to the rate level, public

utilities are entitled to cover all allowable operating costs and to have the opportunity to earn a "fair" rate of return. *Id.* Collectively, these items comprise a company's total revenue requirements. *Id.* As to the rate structure, public utilities are permitted to establish rates that, at a minimum, will cover their revenue requirements. *Id.* at 171-72. Such rates must be "just and reasonable," with no "undue" discrimination. *Id.* at 172.

Thus, in considering the Application of Carolina Water, the Commission must give due consideration to the Company's total revenue requirements, comprised of allowable operating costs and the opportunity to earn a fair rate of return. To this end, the Commission will review the operating revenues and operating expenses of Carolina Water and will endeavor to establish adequate and reasonable levels of revenues and expenses. Further, the Commission will consider a fair rate of return for Carolina Water based upon the record before it. Should the Commission's determination show that rates should be increased, the Commission will then design rates that will meet the revenue requirements of Carolina Water but that are also just and reasonable and free of undue discrimination.

## **II. PRELIMINARY MATTERS**

### **MOTION FOR ADMISSION OF DOCUMENTARY EVIDENCE**

On August 30, 2011, the ORS filed a motion for the admission into the record of this docket the transcript of the hearings held in Docket No. 2010-146-WS.<sup>2</sup> The transcript which the ORS sought to admit involved a Rule to Show Cause proceeding brought against Carolina Water alleging that it had violated Commission regulations pertaining to billing and termination of service. The Rule to Show Cause is still pending. The Commission heard oral arguments on the

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<sup>2</sup> *Petition of the Office of Regulatory Staff for Commission to Order a Rule to Show Cause As to Why Carolina Water Service, Incorporated Should Not Be Found in Violation of Commission Regulations and for Issuance of Order to Provide Adequate and Proper Service*, 2010-146-WS.

ORS' motion at the hearing on September 7<sup>th</sup>. The ORS argued that the transcripts of the Rule to Show Cause hearing were admissible under the Commission's regulations, 26 S.C. Code Ann. Regs. 103-829 and 103-847 (1976). Carolina Water opposed admission of the transcripts arguing that they contained inadmissible hearsay, and did not fall within the exception for admission of testimony given by unavailable witnesses in SCRE Rule 804(b)(1). Carolina Water further contended that admission of the testimony of witnesses at the Rule to Show Cause hearing in the present proceedings would deny the company its right to cross-examination, and therefore violate its procedural due process rights. The Commission agrees with Carolina Water, and denies the ORS's motion. However, the Commission does take judicial notice of the existence of the Rule to Show Cause proceedings.

#### THE STIPULATION BETWEEN CWS AND MIDLANDS

At the hearing, the Company and Midlands submitted a written Settlement Agreement providing that any increase in the contract bulk sewer treatment service rate charged Midlands by Carolina Water for bulk sewer treatment service to Midlands' customers in the Vanarsdale subdivision shall be identical to percentage increase which may be allowed for single family equivalent sewer treatment rate in this docket. Keith Parnell, president of Midlands testified in support of the stipulation.

We find that the stipulation is reasonable and therefore accept the settlement agreement as in the public interest. It is fair and reasonable that the customers served by Midlands receive the same rate treatment as all the other customers served by Carolina Water. The bulk sewer treatment service rate charged Midlands by Carolina Water for bulk sewer treatment service to Midlands' customers in the Vanarsdale subdivision shall be increased as hereinafter set out.

### III. FINDINGS OF FACT AND SUPPORTING EVIDENCE

1. Carolina Water provides water service to approximately 7,644 customers and sewer service to approximately 10,964 customers in portions of Aiken, Beaufort, Georgetown, Lexington, Orangeburg, Richland, Sumter, Williamsburg and York counties. As a public utility, its operations are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §§ 58-5-10 *et seq.*

The evidence supporting this finding is contained in the Company's application.

2. The appropriate test year for purposes of this proceeding is the twelve month period ending September 30, 2010.

The evidence supporting this finding is contained in the Company's application and, the testimony of its witness Lubertozzi [Lubertozzi Pre-filed Direct testimony, Tr. p. 752, 11. 2-4]. No other party objected to the proposed test year.

A fundamental principle of the ratemaking process is the establishment of a test year period. In *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826 (1996), the Supreme Court observed that "[t]he 'test year' concept is very important in the rate-setting process. In order to determine what a utility's expenses and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues." *Id.*, 478 S.E.2d 828, n. 1. The test year is established to provide a basis for making the most accurate forecast of the utility's rate base, reserves, and expenses in the near future when the prescribed rates are in effect. *Porter v. South Carolina Pub. Serv. Comm 'n*, 328 S.C. 222, 493 S.E.2d 92 (1997). The historical test year may be used as long as adjustments are made for any known and measurable out-of-period changes in expenses, revenues, and investments. *Id.* Accordingly, the Commission adopts the test year proposed by the

Company and will make adjustments for any known and measurable changes outside the test year.

3. The Commission will use rate of return on rate base as a guide in determining just and reasonable rates.

The Company requested rate of return treatment in its application and through its witness Steve Lubertozzi. [Lubertozzi Direct Pre-filed testimony, P. 766, ll. 5-10.] Additionally, no other party of record proposed an alternative method for determining just and reasonable rates and the testimony of ORS' witnesses Scott and Carlisle contemplate that return on rate base will be the methodology employed.

The Commission has wide latitude in selecting an appropriate rate-setting methodology. *Heater of Seabrook, supra*, 478 S.E.2d at 830. Even though S.C. Code Ann. § 58-5-240(H) requires the Commission to specify an operating margin in all water and sewer cases, the Commission is not precluded by that statute from employing the return on rate base approach to ratemaking. *Id.* Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary debt and equity capital that a large utility needs for sound operation." *Id.* In the Company's last rate case, we employed the return on rate base methodology. The Company's unadjusted rate base, according to its application, is \$23,989,803. Given the foregoing, and the uncontradicted testimony that the Company has a need to earn a fair and reasonable return on its investment, the Commission finds that the return on rate base methodology is the appropriate methodology to use in this case.

4. The determination of return on rate base requires consideration of three components, namely: capital structure, cost of equity (or return on equity) and the cost of debt. (Ahern Pre-filed Direct testimony, Tr. p. 467, l. 18 – p.468, l. 9).

5. In determining the Company's appropriate return on rate base, the correct capital

structure and cost of debt is that of Carolina Water' parent, Utilities, Inc., at December 31, 2010. Accordingly, for purposes of this proceeding, the correct capital structure is 50.11% (debt) and 49.89% (common equity) and the correct embedded cost of debt is 6.6%. The evidence supporting this finding is contained in the testimonies of Company witness Ahern [Ahern Direct Pre-filed testimony, Tr. p. 468, 11. 4-9] and ORS witnesses Scott [Audit Exhibit SGS-8.] Use of the cost of debt of Utilities, Inc., verified by the ORS audit staff, is appropriate as Carolina Water obtains all of its external financing from its parent, which determines how much income Carolina Water can retain. This approach is also consistent with the analysis we employed in the Company's last rate case.

6. A fair range of return on equity for Carolina Water is 9.54 % -13.45 %. The Commission will employ the midpoint of this range of 11.50% in setting rates. The evidence supporting this finding is contained in the testimonies of Company witness Ahern and ORS witness Carlisle. As noted by witness Ahern, under the standards enunciated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Bluefield Water Works Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1922), a utility is entitled to an opportunity to earn a fair rate of return. [Ahern Direct Pre-filed testimony, Tr. p. 468, 11. 19-22.] The rate of return on common equity is a key figure used in calculating a utility's overall rate of return. *Porter v. South Carolina Public Service Commission*, 333 S.C. 12, 507 S.E.2d 328 (1998).

To determine the cost of equity, both Company witness Ahern employed the Discounted Cash Flow ("DCF") Risk Premium Model ("RPM") and the Capital Asset Pricing Model ("CAPM"). Both DCF and CAPM are market-based approaches relying upon transactions in the securities markets and estimates of investor expectations. Charles F. Phillips, Jr., *The Regulation of Public Utilities* (1993) at 394. ORS witness Carlisle employed the Comparable Earnings Model ("CEM") as well as the DCF and CAPM models.

Ahern assessed the market-based cost rates of similar risk companies, i.e. proxy groups, for insight into a recommended common equity cost rate for Carolina Water. [Ahern Pre-filed Direct testimony, Tr. p. 488, 11. 1-17.] The proxy groups were used by Ahern because the Company's common stock is not publicly traded, and, therefore, Carolina Water's market-based common equity cost rates cannot be determined directly. [Ahern Pre-filed Direct testimony, Tr. p. 468, 11. 11-23.] Therefore, Ahern used a proxy group of 9 water companies whose common stocks were actively traded for insight into an appropriate common equity cost rate applicable to Carolina Water. The basis of selection for the proxy group was to select those companies which meet the following criteria: 1) they are included in the Water Company Group of AUS Utility Reports (July 2011); 2) they have Value Line, Reuters, Zacks or Yahoo! Finance, consensus five-year earnings per share (EPS) growth rate projections; 3) they have a positive Value Line five-year dividends per share (DPS) growth rate projection; 4) they have a Value Line adjusted beta; 5) they have not cut or omitted their common dividends during the five years ending 2010 or through the time of the preparation of this testimony; 6) they have 60% or greater of 2010 total operating income derived from and 60% or greater of 2010 total assets devoted to regulated water operations; and 7) at the time of the preparation of this testimony, they had not publicly announced that they were involved in any major merger or acquisition activity.

The following companies met these criteria: American States Water Co., American Water Works Co., Inc., Aqua America, Inc., Artesian Resources Corp., California Water Service Corp., Connecticut Water Service, Inc., Middlesex Water Company, SJW Corporation and York Water Company.

Ahern's DCF analysis yields cost rates for the proxy group of 9.54% [Ahern Pre-filed Direct testimony, Tr. p. 496, 1. 20 – p. 497, 1. 3.] The results of the RPM analysis produced a

common equity cost rate of 10.33% for the proxy group. [Ahern Pre-filed Direct testimony, Tr. p. 506, 11. 9-10.] Finally, the traditional CAPM cost rate is 10.42% for the proxy group. [Ahern Pre-filed Direct testimony, Tr. p. 510, 1. 27 - p. 511, 1. 8.]

However, Ahern went further and applied the cost of equity models to comparable risk non-price regulated companies. Ahern selected a proxy group of non-price regulated companies comparable in total risk to the proxy group of nine (9) water companies. (Schedule TMA-11). Ahern testified that it is consistent with the Hope doctrine that the return to the equity investor should be commensurate with returns on investments in other firms having corresponding risks based upon the fundamental economic concept of opportunity cost which maintains that the true cost of an investment is equal to the cost of the best available alternative use of funds to be invested. The opportunity cost principle is also consistent with one of the fundamental principles upon which regulation rests--that regulation is intended to act as a surrogate for competition and to provide a fair rate of return to investors. (Ahern prefiled direct testimony, Tr. p. 513, 11. 7-18). The cost rates based upon application of the DCF, RPM, and CAPM models to the non-utility group are 12.05%, 11.38%, and 10.75%, respectively averaging 11.39%. (Ahern prefiled direct testimony, Tr. p. 517, 11. 16-21). Ahern calculated the projected return on book equity, partners' capital or net worth of the comparable group to be 15.50%. When analyzed with her conclusion of 11.39%, the results of the DCF, RPM, and CAPM, Ahern concluded a cost of common equity of 13.45% for the non-price regulated companies (Ahern prefiled direct testimony, Tr. p. 518, 11. 2-6).

Ahern reviewed the results of the application of her cost of common equity models and then adjusted them upward to reflect Carolina Water's greater risk due to its smaller size compared to the proxy group by adding an investment risk adjustment of .5% (50 basis points) to the average cost of equity of both proxy groups. Ahern also applied a financial risk adjustment of negative 8

basis points (a negative 0.08%) to recognize the fact that Carolina Water was less financially risky. Taking the forgoing into consideration, witness Ahern range for return on equity of 9.54% to 13.45%. (Ahern prefiled direct testimony Tr. p. 523, ll. 14-21).

Dr. Carlisle applied the discounted cash flow, capital asset pricing model and the comparable earnings method to calculate his return on equity range of 9.02% to 10.03%. Carlisle also adopted Ahern's capital structure of 50.11% long-term debt and 49.89% common equity. (Carlisle prefiled direct testimony at p. 1335, ll. 1-10). Carlisle employed the use of a proxy group of nine (9) water companies, the same proxy group employed by witness Ahern. (See Exhibit DHC-3).

The Commission accepts the conclusion of Carolina Water's Ahern of a return on equity range of 9.54% to 13.45%. Witness Carlisle's testimony raises two concerns. First, Carlisle's testimony does not take into consideration the risk associated with Carolina Water's small size relative to the proxy group. The Commission is forced to conclude that the upward adjustment of 50 basis points recommended by witness Ahern to reflect Carolina Water's greater relative business risk due its smaller size is conservative. The Commission finds that Ahern's calculation of the DCF (which resulted in an ROE of 9.54%)<sup>3</sup> is a better indicator of the appropriate return on equity than Carlisle's (which resulted in an ROE of 9.02%)<sup>4</sup>. Carlisle's application of the DCF model is inferior to Ahern's because Carlisle averaged his own forecasts of company earnings based on historical data with market analysts' forecasts of earnings in the company proxy group. We agree with Ahern, that the DCF model is based on the Efficient Market Hypothesis which is predicated on the notion that the market, and therefore analysts' predictions, will factor the company's historical performance into their estimates. (Ahern Prefiled Direct Testimony p. 443,

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<sup>3</sup> Ahern Pre-filed Direct testimony, p. 496, lines 20-24.

<sup>4</sup> Carlisle Pre-filed Direct testimony, p. 1343, lines 1-3.

line 7 – p. 496, line 19). Ahern Prefiled Rebuttal Testimony, pp. 534-539). Carlisle's inclusion of his own forecast based on historical measures of growth at an equal weight to the combined average of the analysts' forecasts unduly skews his forecast downward. (Ahern Prefiled Rebuttal Testimony, p. 539 lines 1-10).

In addition, Carlisle's application of the CAPM model to Carolina Water in this docket was inconsistent with his previous application of the CAPM model to other Utilities, Inc. subsidiaries. In the application of the CAPM model to Carolina Water in this docket, Carlisle utilized the geometric mean of historical returns and premiums in his CAPM analysis instead of the arithmetic mean of historical returns and premiums, which captures the effect of changing economic conditions or risk premiums over time. The arithmetic mean provides valuable insight into the variability or riskiness of stock returns and premiums. Absent such insight, investors cannot meaningfully evaluate prospective investment risk. It should be noted that in his application of the CAPM model to recent Utilities, Inc. filings for Tega Cay Water Service, Inc. and United Utilities companies, Carlisle utilized the arithmetic mean to capture the risk associated with those companies. Carlisle offers no explanation for deviating from his customary application of the CAPM model. As Ahern's testimony reflected, Carlisle's CAPM results increased to 10.9% from 9.48% when the CAPM model is applied to Carolina Water consistent with his previous testimony. (Ahern Redirect Testimony Tr. p. 582, l. 5 - p. 590, l. 2). Had Carlisle consistently applied his CAPM analysis to this docket, his CAPM result would fall well within Ahern's range of 9.54% to 13.45%.

7. Using the capital structure of Utilities, Inc. consisting of 50.11% debt and 49.89% common equity, a cost of debt of 6.60%, and a cost of equity of 11.50%, we conclude that an appropriate overall rate of return on rate base of 9.05% is appropriate and should be authorized for

CWS. The evidence supporting this conclusion is found in the testimony of ORS witness Ahern as set out *Supra*. The following table indicates the capital structure of the Company, the cost of debt, the cost of equity as approved in this Order, and the resulting rate of return on rate base:

TABLE A			
	RATIO	EMBEDDED	OVERALL
		COST	COST
Long-term Debt	50.11%	6.60%	3.31%
Common Equity	49.89%	11.50%	5.74%
TOTAL	100.00%		9.05%

8. In its Application, Carolina Water is seeking an increase in its rates and charges for water and sewer service which results in \$2,232,408 of additional revenues to Carolina Water, net of uncollectible accounts. However, based on the Company's rebuttal testimony, and its acceptance of various accounting adjustments proposed by the ORS, the proposed increase is effectively \$1,255,070.

The evidence for the finding concerning the amount of the requested rate increase after agreed upon adjustments is contained in the Application filed by Carolina Water and in the testimony and exhibits of ORS witness Scott. The record reflects that this amount was calculated utilizing the billing units including customer growth included in the Company's Application [Exhibit B, Schedule B]. However, the rebuttal testimony of Carolina Water indicates that it is seeking additional revenues of \$1,202,273 more than booked revenue from water operations; additional revenues of \$49,951 more than booked revenue from sewer operations; additional miscellaneous revenues of \$16,620; and uncollectable accounts of (\$13,774) (KEW 1, Schedule B).

9. The appropriate operating revenues for Carolina Water for the test year under present rates and after accounting and pro forma adjustments are \$7,911,462. The evidence supporting this finding is the rebuttal testimony of Kirsten E. Weeks, to wit, KEW1, Schedule B.

10. The appropriate operating expenses for Carolina Water for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of test-year occurrences are \$6,506,422. The evidence supporting this finding is the rebuttal testimony of Weeks, to wit, KEW 1, Schedule B.

(A) Service Revenues:

The ORS Water and Wastewater Department proposes to normalize water and sewer

revenues for the test year. Details of the water service revenue adjustment of \$260,064 and the sewer service revenue adjustment of \$155,769 totaling \$415,833 combined operating revenues are discussed in the direct testimony of ORS witness Willie Morgan. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(B) Miscellaneous Revenues:

ORS has proposed a two part adjustment to miscellaneous revenues. The first part of this adjustment reflects an increase in Miscellaneous Revenues of \$71,713 for revenues booked as Contributions in Aid of Construction (CIAC). The second part of this adjustment reflects an increase in Miscellaneous Revenues for \$22,681 in non-utility income (Scott Prefiled Direct Testimony, p.1252, ll. 17-21).

In regard to the first part of this adjustment, which increased Miscellaneous Revenues to reflect \$71,713 in CIAC, Carolina Water concurs in this adjustment should the adjustment be assigned to sewer revenues only. The ORS in direct testimony allocated the adjustment between water and sewer revenues. ORS, in Surrebuttal Testimony, has agreed with Carolina Water's position that the adjustment should be directly assigned to sewer only (Scott Prefiled Surrebuttal Testimony p. 1264, l. 15, - p. 1265, l. 3).

In regard to the second part of this adjustment Carolina Water opposes inclusion of \$22,681 in non-utility income. Carolina Water's position related to this adjustment is twofold: First Carolina Water opposes this adjustment based on ORS's position that expenses associated with this non-utility income should be excluded. The ORS position to include non-utility income while excluding non-utility expenses creates an inconsistency from an accounting standpoint. Carolina Water opposes inclusion of the \$22,681 in non-utility income because this revenue was not derived from utility operations, but was earned from the sale of a list to a vendor of insurance products.

Carolina Water also opposes including revenue from this contract because it is non-recurring in nature. (Lubertozzi Cross Examination Testimony, p. 8431, ll. 11-21).

The Commission finds that the company's sale of a customer list to a third-party vendor is non-utility income and should not be considered in setting prospective rates (Weeks Prefiled Rebuttal Testimony p. 889, l. 18 – p.890, l.12).

(C) Uncollectible Accounts:

ORS has adjusted uncollectible accounts at present and proposed rates within 1.1% of ORS proposed service revenues. ORS proposed an adjustment to per book uncollectible accounts of \$342,207 (Scott Prefiled Direct Testimony p.1253, ll. 5-8).

CWS has proposed to adopt the 1.1% uncollectible percentage as proposed by ORS. CWS's proposed adjustment to per book uncollectible accounts is \$335,881 (Weeks Prefiled Rebuttal Testimony p. 890, ll. 18-23).

The Commission adopts the proposed 1.1% uncollectible rate in setting rates on a prospective basis and accepts CWS's adjustment.

(D) Operators' Salaries and Wages:

ORS has annualized operators' salaries and wages by proposing an adjustment to reduce test year expenses by \$13,918. ORS annualized salaries utilizing data available as of June 2011 (Scott Prefiled Direct Testimony p. 1253, ll. 9-15), and objects to including the salaries of employees hired after that date arguing that it has not had the opportunity to audit these positions.

Carolina Water proposes to annualize salaries and wages by increasing test year expenses by \$23,627. Carolina Water annualized salaries utilizing the latest data available as of August 18, 2011 (Weeks Prefiled Rebuttal Testimony p. 894, ll. 5-21). Ms. Weeks testified that the positions were filled in August of 2011 after ORS closed the period for its audit. Her testimony was

credible and there is no reason for the Commission to doubt that the operators' positions in question have been filled and are needed. (Weeks Rebuttal Testimony p. 893, l. 19 – p. 894, l. 21).

The Commission adopts the position proposed by Carolina Water in an effort to utilize the latest available information in setting rates on a prospective basis.

(E) Purchased Sewer and Water:

ORS and the Company proposed to remove \$249,878 for purchased water and sewer pass-through costs from operating expenses. Carolina Water agrees with this adjustment. Furthermore, in addition to the \$249,878 the Company proposes to include \$64,000 as a cost of service in its expenses which would allow the Company to recover its present bulk water costs in its future rates. (Lubertozzi Prefiled Rebuttal Testimony p. 779, ll. 1-10). The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(F) Remove Water Project:

ORS proposes to remove costs for a water project that was expenses in the test year. The total amount of (\$45,500) should be capitalized. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(G) Transportation Expenses:

ORS has annualized transportation expenses to reflect allocated cost for employee usage of Carolina Water vehicles during the test year. ORS proposes to reduce test year expenses by \$63,364 (Scott Prefiled Direct Testimony p. 1254, ll. 1-9).

Carolina Water proposes a similar adjustment to annualize transportation expenses to reflect allocated cost for employee usage of Carolina Water vehicles during the test year. Carolina Water proposes to reduce test year expenses by \$62,394 by utilizing the latest data available as of

August 18, 2011 (Weeks Prefiled Rebuttal Testimony p. 899, ll. 6-23).

For the reasons set out above with regard to operators' salaries, , the Commission adopts the position proposed by Carolina Water in an effort to utilize the latest available information in setting rates on a prospective basis.

(H) Operating Expenses Charged to Plant:

ORS proposes to adjust for a portion of employees' salaries, taxes, and benefits booked to plant for time spent on capital projects. ORS computed an adjustment of \$69,745 to reduce the capitalized salaries charged to plant (Scott Prefiled Direct Testimony p. 1254, ll. 10-13).

CWS agrees that operating expense charged to plant are a function of salaries, benefits, and payroll taxes for employees who capitalize time. CWS proposes an adjustment of \$1,209 based on CWS utilizing updated salaries and employees (Weeks Prefiled Rebuttal Testimony p. 896, ll.7-20).

The Commission adopts the position proposed by CWS in an effort to utilize the latest available information in setting rates on a prospective basis.

(I) Office Salaries and Wages:

ORS proposes to adjust office salaries by annualizing salary information as of June 2011. ORS's proposal would reduce the test year office salary expenses by \$27,000 (Scott Prefiled Direct Testimony p. 1254, ll. 14-19).

Carolina Water proposes to adjust office salaries by annualizing the latest available information as of August 18, 2011. Carolina Water's proposal would reduce the test year office salary expenses by \$28,357 (Weeks Prefiled Rebuttal Testimony p. 895, ll. 3-14).

For the reasons set out above, the Commission adopts the position proposed by Carolina Water in an effort to utilize the latest available information in setting rates on a prospective basis.

(J) Office Supplies & Other Office Expense:

ORS proposes to adjust office supplies and other office expenses to remove non-allowable expenditures totaling \$41,144 (Scott Prefiled Direct Testimony p. 1254, ll. 20-23).

Carolina Water does not oppose the ORS position with the exception of ORS's elimination of cost associated with the Company's purchase order system. Carolina Water proposes to remove non-allowable expenditures totaling \$39,947 (Weeks Prefiled Rebuttal Testimony p. 899, l. 25 – p. 14, l. 5).

The Commission adopts the position proposed by Carolina Water and finds that cost associated with the purchase order system should not be excluded from the non-allowable expenditures.

(K) Regulatory Commission Expense:

ORS proposes to amortize rate case expenses incurred for this rate case proceeding over a three-year period. ORS's adjustment to rate case expense resulted in a reduction of test year rate case expense of \$207,386 (Scott Prefiled Direct Testimony p. 1255, ll. 1-7).

CWS proposes to amortize rate case expenses incurred for this rate case proceeding over a three-year period. CWS's adjustment utilized the latest rate case expense and resulted in a reduction of test year rate case expense of \$130,953 (Lubertozi Prefiled Rebuttal Testimony p. 779, l. 22 – p. 780, l. 9).

However, the Commission ordered the ORS to audit all remaining rate case expenses of the hearing. Lubertozi estimated that these expenses would total \$406,351.85. (Lubertozi Prefiled Rebuttal Testimony p. 779, l. 22- p. 780, l. 9). The ORS has objected to the remaining expenses without auditing them. The Company's expenses are presumptively valid, and absent a substantiated objection, which the Commission does not have in this record, they are entitled to

approval. The Commission adopts the position proposed by CWS in an effort to utilize the latest available information in setting rates on a prospective basis.

(L) Pension and Other Benefits:

ORS has proposed to annualize pension and health benefits associated with the salary adjustment for operators and office employees. ORS proposed to reduce per book expense by \$40,464 (Scott Prefiled Direct Testimony p. 1255, ll. 8-12).

CWS has proposed to annualize pension and health benefits using the latest information available as of August 18, 2011. In addition CWS proposes to include 401(k) and profit sharing at actual percentages for each current employee. The 401(k) Profit Sharing Plan has replaced the Company's former traditional defined benefit plan. The profit sharing is offered to all employees and based on the Company's performance (Weeks Prefiled Rebuttal Testimony p. 897, l. 12 – p. 898, l. 4). The CWS adjustment increases per book expense by 24, 619.

The Commission adopts the position proposed by CWS in an effort to utilize the latest available information and finds that 401k and profit sharing expense should be included in setting rates on a prospective basis.

(M) Non-Utility Miscellaneous Income and Expenses:

ORS proposes to reduce operating expenses for items not related to utility operations. The total adjustment removes (\$13,059) from operating expenses. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(N) Interest on Customer Deposits:

ORS proposes to annualize interest on customer deposits by using the customer deposit balance of \$193,657 at year end and the PSC approved interest rate of 3.5%. ORS computed

interest on customer deposits of \$6,778, less the per book amount of \$5,501, for an adjustment of \$1,277. During ORS's account analysis, it was discovered that the accrued interest account was reduced by (\$253,041) to reflect a true-up for customer deposits. The company stated that in 2009 it did a reconciliation of customer accounts receivable and in the process true-up customer deposits and accrued interest. This issue is further discussed by ORS witness Dawn M. Hipp. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(O) Depreciation Expense:

ORS proposes to annualize depreciation expense for known and measurable plant in service amounts through June 2011. The result of this adjustment is to reduce test year depreciation expense by \$47,505 (Scott Prefiled Direct Testimony p. 1256, ll. 3-8).

Carolina Water proposes to annualize depreciation expense for known and measurable plant in service. The result of this adjustment is to reduce test year depreciation expense by \$8,517. There are a number of areas which make up the difference in the ORS and Carolina Water adjustments including different amounts for non-allowable plant, capitalized wages, updated vehicle information and inclusion of the CC&B system (Weeks Prefiled Rebuttal Testimony p. 902, ll. 12-20).

The Commission adopts the position proposed by Carolina Water. The use of updated information and the inclusion of CC&B should be used in setting rates on a prospective basis.

(P) Amortization of Contributions in Aid of Construction ("CIAC"):

ORS in their original testimony proposed an adjustment to amortize CIAC in the amount of \$13,190. However in their surrebuttal testimony ORS has changed the amortization amount to \$12,114 (Scott Prefiled Surrebuttal Testimony p. 1265, ll. 3-7).

Carolina Water concurs with ORS's revised amortization amount of \$12,114.

The Commission adopts the adjustment agreed to by the Company and ORS.

(Q) Payroll Taxes:

ORS Position: ORS Proposes to adjust for payroll taxes associated with the adjusted test year salaries. The payroll taxes include FICA, and state and federal unemployment taxes. ORS proposes to reduce per book payroll tax expense by \$7,045 (Scott Prefiled Direct Testimony p. 1256, ll. 14-17).

CWS Position: CWS's adjustment includes payroll taxes for all current salaries updated for positions filed as of August 18, 2011. The effect of CWS's adjustment is to increase per book payroll taxes by \$2,041(Weeks Prefiled Rebuttal Testimony p. 897, ll. 2-10).

The Commission adopts the position proposed by CWS in an effort to utilize the latest available information in setting rates on a prospective basis.

(R) Utility/Commission Taxes:

ORS proposes to adjust for gross receipts and utility/commission taxes. A total factor of .00951022, comprised of the SCDOR factor of .003 and the PSC/ORS factor of .00651022, was used to compute this adjustment. Using total pro forma revenues of \$852,437 multiplied by .00951022 resulted in an adjustment of \$8,106. CWS does not oppose the factors as computed by the ORS, but proposes to apply the factors to its revenue proposal. The Commission concurs with CWS and adopts its position.

(S) Income Taxes:

ORS proposes to adjust income taxes after accounting and pro forma adjustments. ORS used a 5% rate for state income taxes and a composite rate of 35% for federal income taxes. Details of the computation of income taxes are shown in SGS-6. See Adjustment R above.

(T) Interest During Construction:

ORS proposes to remove the income associated with capitalized interest for projects under construction. Carolina Water does not propose to include construction work in progress (“CWIP”) in rate base, and therefore, the income associated with CWIP is not included as an offset to expenses. The adjustment amounted to (\$9,437). Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(U) Interest on Debt:

ORS proposes to eliminate interest expense of \$653,687 from the computation of net income. Interest expense is considered for the computation of the operating margin. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(V) Customer Growth:

ORS proposes to adjust for customer growth after the accounting and pro forma adjustments. The ORS Water and Wastewater Department computed growth factors of 1.19126% for water and .87421% for sewer. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(W) Vehicles:

ORS proposes to adjust for the allocation of vehicles to CWS employees. In addition, ORS removed unused and inoperable vehicles. ORS proposes an adjustment to remove \$365,155 from per book plant in service (Scott Prefiled Direct Testimony p. 1257, ll. 17-22).

CWS has proposed a similar adjustment to properly allocate vehicles to CWS employee and to account for vehicles no longer in use. CWS in rebuttal testimony proposes to remove \$221,737 from per book plant in service (Weeks Prefiled Rebuttal Testimony p. 901, ll. 7-18).

The Commission adopts the position proposed by CWS to recognize vehicles included at the latest possible date. Utilization of the latest possible information should be used in setting rates on a prospective basis.

(X) Plant Additions:

ORS proposes to adjust for known and measurable net plant additions after the test year. The Company provided actual plant additions and retirements of \$1,935,741 through June 2011. The Company's application amount of \$1,251,683 was based on actual and estimated expenditures. Based upon ORS' examination, \$59,340 of these proposed additions were disallowed. ORS proposes an adjustment to include the remaining net plant additions of \$1,876,401. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(Y) Capitalized Wages:

ORS proposes to adjust plant for a portion of operators' salaries, taxes, and benefits associated with capital projects for the test year. ORS's capitalized salary adjustment reduces plant in service by \$69,745 as reflected in Adjustment H (Scott Prefiled Direct Testimony p. 1258, ll.8-11).

CWS proposes to adjust plant for a portion of operators' salaries, taxes, and benefits associated with capital projects for the test year. CWS in its adjustment has used updated salaries and employees. CWS capitalized salary adjustment increases plant in service by \$1,209 as reflected in Adjustment (H) (Weeks Prefiled Rebuttal Testimony p. 896, ll. 7-20).

The Commission adopts the position proposed by CWS in an effort to utilize the latest available information in setting rates on a prospective basis.

(Z) Gross Plant In Service:

ORS proposes to capitalize expenditures of \$45,500 associated with a water project that was expensed in the test year. Carolina Water agrees with this agreement. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(AA) Computers:

ORS proposes to update allocated computers and remove a portion of the Customer Care and Billing System costs. ORS's proposal reduces test year plant in service by \$397,643 which includes removal of 74.65% of the initial Customer Care and Billing System and removal of other non-allowable expenditures related to Project Phoenix.

The ORS witness Hipp testified that the CC&B system was not providing timely and accurate bills to the water distribution and wastewater collection customers. ORS acknowledges that the CC&B system provides operational and administrative efficiencies that benefit customers. However, basing her testimony on customer complaints and a review of bills and revenue records, Hipp concludes that the CC&B system design and implementation were deficient. The ORS removed 74.65% of the initial cost of CC&B because, as Hipp testified, "this percentage reflects the percent of water distribution and/or wastewater customers who have been affected by the billing deficiencies CC&B stemming from poor design and implementation (Hipp Prefiled Direct Testimony p.8 ll. 6-19.) However, she offered no evidence or data to substantiate her assertion. The Commission lacks the necessary evidence on which to base a finding that 74.65% of Carolina Water's customers were affected by billing problems associated with CC&B.

Furthermore, the Customer Care and Billing system does not perform only billing functions. The CC&B system provides software for customer management and service, accounts receivables and collections, devise management, meter reading as well as billing (Lubertozzi pre-filed direct testimony p.14, ll. 15-22.) The record does reflect that there were certain billing

delis when the CC&B system was initially implemented (Sasic Prefiled Direct Testimony p. 1062, l 7 – p. 1065, l.5.) However, the initial billing concerns were remedied within a reasonable period time. The billing concerns which arose in 2010 were generally categorized as late bills, prorated base facility charges and bills which were received by Carolina Water's customers. There is no evidence of record that CC&B was the reason Carolina Water's customers did not received bills. The confusion arose because Carolina Water undertook to terminate service of those customers who submitted no payment for service charges. This billing issue appears to have been a onetime event (Sasic Prefiled Direct Testimony p. 1007, l.10 – p. 1071, l.18).

The inappropriate prorated bills were the result of the application of a programming function designed to protect Carolina Water customers from inaccurate bills. Certain bill prorations are appropriate in cases of new customers who connect in the middle of a billing cycle or existing customers who terminate in the middle of a billing cycle. The CC&B system is designed to properly prorate these bills. However, the CC&B also prorates bills of customers whose meters were read earlier or later than schedules (Sasic Prefiled Direct Testimony p. 1065, l. 16 – p. 1067, l. 14). There is no evidence in the record that this was an implementation or design flaw. Ms. Sasic resolved this issue in February of 2011 and it appears to be fully resolved.

Last, the late billing are not the result of an implementation or design flaw. The late bills are the result of the tariff under which Carolina Water has been operating. The principal reason for the delay of Carolina Water's customers who are receiving bulk services is the delay in Carolina Water's receiving the invoice from the bulk service providers. Once Carolina Water receives the invoices from its bulk providers, Carolina Water now takes approximately three days to process and bill its customers. As noted elsewhere in this order, the Commission has determine to modify Carolina Water's tariff so as to permit it to bill its customers served by bulk service

providers promptly which should have the effect of minimizing any billing delays. Moreover, the Commission points to the testimony of Ms. Sasic reflecting that Carolina Water billing has largely resolved all of these billing issues, a fact which is uncontested by any other party (Sasic Prefiled Direct Testimony p. 1073, l.6 – p. 1074, l.7). The ORS has offered no evidence through expert testimony or otherwise which convinces the Commission that the billing was the result of a design flaw in the Customer Care and Billing system. Moreover, the ORS recommendation is punitive. The CC&B system provides considerably greater benefit to Carolina Water and its customers than the billing function. Last, the ORS has offered no data as to how it arrived at its figure of 74.65%. Accordingly, the Commission finds no design flaws in the Customer Care and Billing system and will deny the ORS request to remove any portion of the Customer Care and Billing system from rates. Accordingly, the entire costs attributable to South Carolina of the Customer Care and Billing system shall be placed in rates.

In summary, CWS proposes that computers have been allocated properly, Project Phoenix cost should be included in plant in service, and that the entire initial cost of the Customer Care and Billing System should be included in Plant in Service during the test year.

The Commission adopts the position proposed by CWS. In doing so the Commission finds that the Customer Care and Billing System has been proven to meet the used and useful test.

(BB) Excess Book Value:

ORS proposes to remove net excess book value as approved in previous rate cases. The total excess book value of \$1,937,905 is amortized at 1.50% and is shown as a reduction to depreciation expense of (\$29,069) on Audit Exhibit SGS-5. Excess book value of (\$743,227), which is net of the accumulated amortization, is removed from plant in service. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water

and the ORS.

(CC) Non-allowable Plant:

ORS proposes to reduce plant in service by \$508,123 to reflect non-allowable plant. In addition ORS has removed DHEC costs that should have been expenses in a previous year (Scott Prefiled Direct Testimony p. 1259, ll. 8-15).

CWS proposes to reduce plant in service by \$408,895 to reflect non-allowable plant. CWS proposes to include some plant as it is used and useful and therefore should not be deemed non-allowable (Weeks' Prefiled Rebuttal Testimony p. 901, l. 2 – p. 15, l.7).

In particular, the ORS proposed adjustments constitute \$99,228 in expenditures associated with engineering services provided by Burgin Engineering and Sims Group in designing improvements to the Lincolnshire wastewater treatment facilities. Carolina Water witness Flynn testified that the expenditures are appropriate because they represent investment necessary to analyze the condition of the treatment facility and to develop plant improvement options and to provide recommendations to meet DHEC design guidelines. The expenditure of \$99,228 towards engineering costs are necessary. (Flynn Prefiled Rebuttal Testimony p. 967, ll. 2-9)

The Commission adopts the position proposed by CWS and finds that the plant in service items in question to be used and useful and therefore allowable in plant in service.

(DD) Accumulated Depreciation:

ORS proposes to adjust accumulated depreciation by \$682,310 to reflect depreciation expense for general plant, pro forma retirements after test year, vehicle and computer adjustments and non-allowable plant (Scott Prefiled Direct Testimony p. 1259, ll. 16-19).

CWS proposes to adjust accumulated depreciation by \$371,707 to reflect depreciation expense for general plant, pro forma retirements after test year, vehicle, computers and

non-allowable plant. (See Adjustments AA and CC above). The variance between ORS and CWS is in CC&B, non-allowable plant, and vehicle balances. (Weeks Prefiled Direct Testimony p. 90, 116-10).

The Commission adopts the position proposed by CWS. In doing so the Commission finds that depreciation on the entire amount of investment in CC&B allocated to South Carolina should be deemed to be used and useful. In addition the Commission adopts CWS's position related to non-allowable plant and vehicle balances.

(EE) Cash Working Capital:

ORS proposes to adjust cash working capital for accounting and pro forma adjustments using a 45-day or 12.50% allowance of maintenance and general expenses. See Audit Exhibit SGS-7. Carolina Water does not disagree with the allowable rate of 12.5%. However, CWS proposed that the allowable rate be applied to expense levels for maintenance and expense levels proposed by Carolina Water. The Commission adopts the position of Carolina Water with respect to the application of the allowance

(FF) CIAC After Test Year:

ORS proposes to adjust CIAC to reflect contributions made after the test year of (\$856,576). Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(GG) CIAC Amortization:

In surrebuttal testimony ORS proposes to adjust CIAC by \$12,114 to reflect amortization from Adjustment (P).

CWS concurs with ORS's revised amortization amount of \$12,114.

The Commission adopts the adjustment agreed to by ORS and CWS.

(HH) Annualize Customer Deposits:

ORS proposes to adjust for the effect of annualized customer deposits on rate base of (\$1,277) as shown in Adjustment N. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(II) Correct Customer Deposits Balance:

ORS proposes to adjust customer deposits by (\$10,791) to reflect the correct per book balance for sewer operations. Carolina Water agrees with this adjustment. The Commission adopts the adjustment agreed to by Carolina Water and the ORS.

(JJ) Service Revenue:

As provided by the CWS rebuttal testimony, Carolina Water's proposed rates would produce additional revenues of \$1,202,273 for water operations and \$49,951 for sewer operations.

(KK) Miscellaneous Revenue:

As provided by the ORS Water and Wastewater Department, an adjustment was made for \$269,437 for miscellaneous revenue associated with Company's proposed rate increase for charges such as disconnection charges, tampering charges and pumping charges. Details of the adjustment are shown in the direct testimony of ORS witness Willie Morgan. In response, CWS proposed to adjust miscellaneous revenues by \$16,620 for a total increase in miscellaneous revenue of \$253,289 (KEW 1, Schedule B). The Carolina Water position is more realistic and is adopted by the Commission.

(LL) Uncollectible Revenue:

ORS proposes to adjust for uncollectible accounts by (\$805) for the Company's proposed rate increase. The uncollectible amount was provided by ORS witness Willie Morgan. Carolina Water proposes that, consistent with its proposed increase in water and sewer revenues set out in

its rebuttal testimony, the uncollectible revenue amount should be \$13,774 (Weeks Prefiled Rebuttal Testimony p. 890, l. 14 – p. 891, l. 3; KEW 1, Schedule B). The Commission adopts the Carolina Water position.

(MM) Taxes Other Than Income:

ORS proposes to adjust gross receipts and utility/commission taxes associated with the revenues after the Company's proposed increase. A total factor of .00951022, comprised of the SCDOR factor of .003 and the PSC/ORS factor of .00651022, was used to compute this adjustment. ORS's total adjustment is \$28,232 using the Company's proposed increase of \$2,968,522 and .00951022. CWS proposes to calculate taxes on a proposed increase in revenue of \$1,255,070. The Commission adopts CWS' calculations.

(NN) Income Taxes:

ORS proposes to adjust for income taxes associated with the Company's proposed rate increase based on the ORS' recommended revenue requirement. See Audit Exhibit SGS-6 for the computation of income taxes. CWS proposes to calculate taxes on a proposed increase in revenue of \$1,255,070. In light of the Commission's findings concerning the appropriate revenue requirement for the Company, the Commission adopts CWS' calculations.

(OO) Customer Growth:

ORS proposes to adjust for customer growth after the Company's proposed increase. The growth factors of 1.04167% for water and .70796% for wastewater were computed by the ORS Water and Wastewater Department. CWS proposes no customer growth adjustment. Because there is no evidence in the record to support the ORS's assumptions regarding customer growth, The Commission shall set rates based on no customer growth.

Summary of Adopted Adjustments to Expenses:

The total effect of the adjustments to test year expenses adopted herein increase Operating and Maintenance Expenses by \$228,457, decrease General and Administrative Expenses by (\$201,034), decrease Depreciation and Amortization Expenses by (\$20,632), decrease Taxes Other Than Income by (\$15,183), increase state and federal Income Taxes by \$174,971, and increase Interest on Customer Deposits by \$1,277. The net effect of the adjustments adopted herein on Total Operating Expenses is to increase Total Operating Expenses by \$167,856. Thus, operating expenses for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences are \$6,506,422.

The following table indicates the Company's gross revenues for the test year after adjustments approved herein, under the presently approved rate schedules; the Company's operating expenses for the test year after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences approved herein; and the rate of return on rate base under the presently approved schedules for the test year:

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TABLE B

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	Before Increase
Operating Revenues	\$7,911,462
Operating Expenses	6,506,422
Net Operating Income	\$1,405,039
ADD: Allowance for Funds Used	0
During Construction	
Customer Growth	0
TOTAL INCOME FOR RETURN	\$1,405,039

Return on Rate Base

5.85%

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11. The appropriate rate base for Carolina Water for the test year after accounting and pro forma adjustments and adjustments for known and measurable occurrences outside the test year is \$24,005,206. The evidence supporting this finding is contained in KEW 1, Schedule C.

12. The net operating income requirement for Carolina Water, using the return on rate base of 9.05% found appropriate in this Order and the adjusted rate base of \$24,005,206, is \$2,172,691.

Under rate of return on rate base regulation, the Commission must approve an income requirement that will permit the Company to cover operating costs and provide an opportunity to earn the approved rate of return on rate base. The determination of the income requirement requires a calculation using approved Operating Revenues and approved Operating Expenses to determine Net Operating Income for Return. The following table illustrates the calculations of Carolina Water's Total Income for Return:

TABLE C

	<u>After Increase</u>
Operating Revenues	\$9,166,531
Operating Expenses	<u>6,993,840</u>
TOTAL INCOME FOR RETURN	\$2,172,691
Return on Rate Base	<u>9.05%</u>

As demonstrated on Table C, Total Income for Return after the increase approved herein is \$2,172,691.

13. In order for Carolina Water to have the opportunity to earn its income requirement of \$2,172,691, Carolina Water must be allowed additional revenues totaling \$1,268,844 or

\$1,255,070 after uncollectibles.

In order for the Company to have the opportunity to earn the 9.05% rate of return on rate base approved herein, the Commission must increase revenues sufficient to achieve a Total Income for Return of \$2,172,691, as calculated in Finding of fact No. 12. The additional revenue calculated for the Company to have the opportunity to earn its approved rate of return of 9.05% requires an increase of \$1,268,844.

14. The resultant operating margin for Carolina Water, based upon the adjustments and rates approved herein, is 15.02%. S.C. Code Ann. Section 58-5-240(H) provides, in part, that "[t]he [C]ommission shall specify an allowable operating margin in all water and wastewater orders." Based upon the rate of return on rate base approved herein and the revenues and expenses also approved herein, the corresponding operating margin is calculated to be 15.02%. The following Table reflects an operating margin of 15.02%:

TABLE D	
Operating Revenues	\$9,166,531
Operating Expenses	6,993,840
Total Income for Return	\$2,172,691
Operating Margin	15.02%

(After Interest Expense of \$795,676)

16. The Company's requested modifications to its water and sewer rate schedule provisions pertaining to connection charges, meter installation charge, tampering charge, and pumping charge are appropriate as being in the public interest and are hereby approved.

- a. Disconnection Charge for Sewer Service with Elder Valve Present. Carolina Water proposed a disconnection charge of \$35.00 in those cases where an elder valve is already in place. The \$35.00 charge reflects the recovery of the cost for a

customer service representative to schedule the disconnection and for a field employee to perform the disconnection and to reverse the process once payment has been made. The disconnection charge in this instance would apply to sewer customers who have been disconnected for a reason set out in R.103-532.4, who have vacated their premises and/or who have received notification that their service will be terminated (Flynn Prefiled Direct Testimony at p. 945, ll. 6-17). The ORS objects to the proposed charge on the basis that there is no evidence that \$35.00 is the actual cost of disconnection (Morgan Prefiled Direct Testimony p. 1312, ll. 7-11). However, the record shows that the \$35.00 fee is intended as a minimum charge for disconnection and is reasonable under the circumstances and the Commission finds this charge to be in the public interest and reasonable (Flynn Prefiled Rebuttal Testimony p. 969, ll. 4-13).

- b. Disconnection Charge for Sewer Service with Elder Valve Not Present. Carolina Water proposes a disconnection charge at its cost in those circumstances outlined above where no elder valve is present. The elder valve serves an important function in those cases where Carolina Water does not control the water meter. It is important for Carolina Water to be able to terminate service (Flynn Prefiled Rebuttal Testimony at p. 11, ll. 14 - p. 12, l. 18). The ORS objects to this charge on the basis that Carolina Water does not establish a specific amount of the charge (Morgan Prefiled Direct Testimony at p. 11, ll. 3-11). In response, Carolina Water has offered to limit this charge to \$300.00, a safeguard the Commission finds will give customers adequate notice of this charge. Because the use of the elder valve will enable Carolina Water to control its costs and is in the public interest and

accordingly the Commission approves the disconnection charge at cost with the \$300..

- c. Meter Installation Charge. Carolina Water requests that the Commission approve a tariff provision which authorizes Carolina Water to bill the installation of all water meters except the 5/8" x 3/4" water meter at Carolina Water's actual cost of installation. Typically, customers requesting a meter larger than 5/8" x 3/4" are commercial or irrigation customers. By their nature, commercial and irrigation water services vary greatly in terms of quantity and type of materials used to establish a new service point. By establishing that the cost to install these larger meters will be an actual cost, the new customer will bear his full cost without subsidy from existing customers or the utility. (Flynn Prefiled Direct Testimony, p. 10, ll. 9-18). The ORS objects to the proposed charge as being unnecessary. While it is true that this tariff provides that all meters 5/8" x 3/4" shall meet the utility standards and be installed by the developer, the requested fee addresses meters larger in size. The ORS also suggests that the language is ambiguous (Morgan Prefiled Direct Testimony at p. 1314, ll. 1-5). However, the language is clear and unambiguous. The proposed tariff position places the cost of these meters on the party incurring the cost. The Commission finds the water meter installation charge to be appropriate and in the public interest.
- d. Tampering Charge. The utility seeks authorization to establish a tampering charge which Carolina Water may charge the customer responsible for causing damage to its equipment and facilities by tampering. The charge would permit Carolina Water to have in place the means to recover the cost of damages without requiring

law-abiding customers to subsidize the cost of repairing damage to a line which has been tampered with. In addition, the establishment of a tampering charge will act as a deterrent against customers damaging the utility's assets. (Flynn Prefiled Direct Testimony p. 946, ll. 5-12). The ORS objects to the tampering charge on the basis of the difficulty of proving tampering (Morgan Prefiled Direct Testimony p. 1314, ll. 17 - p. 14, l. 7). However, it is clear from the record that Carolina Water does not anticipate imposing a tampering charge except when meter tampering is established in accordance with the Commission's regulations. S.C. Code Ann. Reg 103-733.5. The Commission finds that the tampering charge is in the public interest and appropriate.

- e. Pumping Charge. Certain of Carolina Water's customers receive sewage collection service through and approved solids interceptor tank which are required to have their contents pumped out periodically. The recommended interval for pumping varies from two to five years. The cost to Carolina Water can vary from \$150 to \$500 if the pump-out is scheduled during normal business hours and as much as \$1,000 if the pump-out is required on an emergency basis. (Flynn Prefiled Direct Testimony p. 946, l. 23 - p. 947, l. 12). The ORS objects to the pumping charge on the basis that Carolina Water cannot prove the actual cost of pumping (Morgan Prefiled Direct Testimony p. 1315, ll. 8-19). Actual costs are unknown and will vary with each instance. However, the recommended charges give customers some certainty regarding the charges, and the evidence of record does contain evidence indicating that the cost of pumping will likely fall within the proposed range (and almost certainly not be lower) as a result the Commission

finds the proposed pumping charge to be in the public interest and appropriate.

f. Account Set-Up Charges. Carolina Water requests that its water and wastewater account set-up charges be increased. This one-time fee reflects the initial cost to establish service in terms of time and expense incurred by utility staff. In particular, Carolina Water proposed to increase its account set-up charge for its water and sewer customers to \$30.00. In addition, Carolina Water proposes to increase its notification fee to those customers subject who service is subject to being discontinued to \$15.00. (Flynn Prefiled Direct Testimony p. 946, ll. 13-22; Application) The ORS does not seem to object to any of these charges. The Commission finds them in the public interest and appropriate.

g. Reconnection Charges. The ORS proposes to reduce the reconnection fee for water service from \$35 to \$25. However, the ORS offers no justification for this reduction. The fee of \$35 was and continues to be reasonable, appropriate and in the public interest. Accordingly, the Commission finds that the reconnection fee for water service of \$35 is in the public interest.

17. Eliminating Delays in Bulk Water Billing.

Acknowledging that the billing delays resulting from the implementation of the pass-through provisions of its current tariff were unacceptable to its customers, Carolina Water proposed to eliminate the “pass through” provisions of its tariff and collect from its customers affected by bulk water sales a water supply charge as follows:

...Carolina Water would propose that where a customer is served by a Carolina Water Service System that is supplied with bulk water, beginning on the first day of the month following the effective date of the Commission Order approving this proposal, Carolina Water may collect from the customer a water supply charge that is based upon 115% of the effective price per thousand gallons (or other unit of measure converted to thousands of gallons) for bulk water

established by Carolina Water bulk water suppliers, which would include any base facilities charge imposed by its bulk water suppliers.

The proposed water supply charge would eliminate the need for delay in the billing of these customers. (See Flynn Prefiled Rebuttal Testimony, p. 961, ll. 1-21.) Thereafter, Carolina Water would be entitled to increase the water supply charge to reflect increases in bulk water prices or base facilities charges that may be adopted by bulk water supplier. In no event would Carolina Water collect more than 115% of the effective price established by Carolina Water's bulk water suppliers. (id.) The basis for the addition of 15% to the price of bulk water is to allow for a 15% non-account water adjustment and adjustments for utility water use such as flushing and plant usage, documented system leakage, and other authorized uses. (Flynn Prefiled Rebuttal Testimony p. 961, l. 21 – p. 4, l. 13.) Flynn testified that “systems with distribution losses in the less than 10% range can be considered excellent; with 10% to 20% losses in the reasonable range.” Carolina Water's allowance for non-account water use with York County is 15% and thus Carolina Water's proposal in this docket would be consistent system-wide. (Flynn, Prefiled Rebuttal Testimony p. 962, l. 14 - p. 5, l. 14.)

Carolina Water further purposed that the water supply charge be reviewed annually by the ORS to determine whether or not the 115% charge should be modified subject to Commission approval. Carolina Water will immediately begin a water audit of its systems using the water audit methodology provided through the American Water Works Association (“AWWA”) beginning with the I-20 system which has the highest percentage of unaccounted for water; thereafter, Carolina Water will conduct an annual water audit. In the event the water audit reflects that the systems percentage of non-account adjustment is greater than 15% Carolina Water will develop a prudent cost effective plan to address excess non-account water loss. The results of all surveys will be shared with ORS. (Flynn, Prefiled Rebuttal Testimony p. 963 l. 16 - p. 6, l. 11.)

Flynn testified that the financial impact of Carolina Water of a non-account water loss of 15% would result in the loss of sixty-four thousand (\$64,000.00) dollars in expenses not recovered in revenue; thus, it will be in Carolina Water's best interest to locate and cure the source of water loss in all of its systems. (Flynn, Prefiled Rebuttal Testimony p. 964, l. 19 - p. 7, l. 2.) Carolina Water proposes that it be permitted to recover the cost of water over and above 15% as a cost of service. (Lubertozi, Prefiled Rebuttal Testimony p. 779, ll. 1-9). If Carolina Water's proposal is approved, it will no longer have to await the issuance of bulk supplier bills and manually post the bills minimizing the potential for billing errors and delays. The proposal will provide Carolina Water customers with timely information regarding water consumption and will provide stability in the consumption rate for month to month. (Flynn, Prefiled Rebuttal Testimony p. 7, l. 15 - 22).

The ORS proposes that Carolina Water not be provided the opportunity to recover any non-account water, or, in the alternative, that if Carolina Water is allowed to recover for non-account water that it be permitted to recover at a figure of 10% as opposed to the 15% proposed by Carolina Water. ORS Witness Hipp testified by proposing a solution to billing delays which would eliminate the words "on a pro-rata basis" from Carolina Water's existing tariff. Hipp testified the effect in so doing would be to permit Carolina Water to bill its customers only for their consumption with no allowance for non-account water. Alternatively, Hipp testified that were the Commission to accept Carolina Water's proposal as set out, that the Commission set the figure for non-account water at 10%.

The Commission adopts Carolina Water's proposal as being reasonable and in the public interest. First, it is important to note that Carolina Water is currently billing a tariff approved by this Commission. The delays result from Carolina Water's application of its tariff. Moreover, the ORS has not brought to the Commissions' attention any circumstance where any other water

company is not permitted to recover its non-account water in some fashion either as an allowance, or in cost of service. The ORS's initial recommendation prohibiting Carolina Water from recovering non-account water is unreasonable, punitive and not in the public interest.

Moreover, Carolina Water is voluntarily offering to move from a tariff where it recovers all of its non-account water to a tariff with greater risks. The Commission may indeed conclude at some point that a 10% allowance is reasonable but as an inducement to Carolina Water to move towards minimizing its water loss, an allowance of 15% is a step in the right direction. Once Carolina Water has performed its water audit and the ORS has reviewed the results of the water audit, the parties under Carolina Water's proposal will be free to come before this Commission seeking a different percentage of non-account water allowance. In this regard, the Commission would expect Carolina Water to be very aggressive in conducting its water audit and in taking steps to identify and to eliminate unnecessary water loss.

18. Customer Service:

This Commission is aware that this Order may be a source of some public dissatisfaction. The law requires that Carolina Water be allowed to earn a reasonable rate of return for its services, and in deciding on such a rate, the Commission is constrained by the evidence before it and the applicable law. No party to this case argued that Carolina Water application for a rate increase should be denied altogether, they only disagree as to the size of the recommended increase. The Commission considered the rate of return testimony provided by Carolina Water's expert witness and the testimony of the expert called by the Office of Regulatory Staff and set a rate accordingly. We have considered the testimony of the many Carolina Water customers who attended public hearings and expressed dissatisfaction with the service which they are receiving and the rates that they are paying. However, we have also considered the detailed responses to

specific customer complaints offered by the company through the testimony of its operators Mac Mitchell and Bob Gilroy. We are persuaded from this testimony that there is no systematic breakdown in service warranting denial of this application or even a penalty. In fact, the Company has demonstrated that it tracks customer complaints and responds to them in a timely fashion.

Furthermore, Forty Love has argued that the Company's application should be denied altogether because of its residents' dissatisfaction with the quality of well water in that subdivision. The Commission sympathizes with the frustration of these customers but denial of the rate application due to the problems experienced in one subdivision would directly contradict the Supreme Court's holding in Utilities Services of South Carolina, Inc. v. South Carolina Office of Regulatory Staff 392 S.C. 96, 112, 708 S.E.2d 755, 764 (2011). In Utilities Services, the Supreme Court clearly held that a finding that a utility's particular expenditure was unreasonable cannot be the basis for denying an application altogether. In other words, the Commission's remedy must be commensurate to the perceived deficiency in the Company's practices or expenditures. Forty Love has proposed no such remedy. In any case, with regard to Forty Love, the record shows that the Company was responsive to the Forty Love customers' complaints, investigating reports of poor water quality when they were reported by customers, meeting with the neighborhood association to keep it apprised of its records, cooperating with the DHEC to conduct testing of its wells, and implementing mitigation measures which appear to have at least had some beneficial effect (Gilroy Prefiled Direct Testimony p. 1173, l.5 – p. 1174, l. 16; p. 1182, l. 11 – p. 1183, l.10).

Furthermore, there is no evidence that the water quality at Forty Love is the fault on the part of the Company. The Company also acknowledges that the current situation is not

satisfactory, in as much as customers continue to complain of poor water quality, foul odor, and sedimentation, and has pledged to explore additional remedies, including but not limited to interconnection with the nearby City of Columbia's water system. The Commission is also committed to seeing improvement in this situation. Carolina Water shall report to the Commission, no later than six (6) months from the date of this order on its investigation of these additional mitigating measures with cost estimates and explanations of feasibility.

19. Performance Bond:

It is in the public interest to continue to require a performance bond in the amount of \$700,000 for the Company. Carolina Water currently has a bond of \$350,000 for water operations and \$350,000 for sewer operations. The Commission's regulations state bond amounts must range from an amount not less than \$100,000 and not more than \$350,000. See S.C. Code Ann. Section 58-5-720. Neither Carolina Water nor the ORS propose to reduce Carolina Water's bonds.

#### **IV. CONCLUSIONS OF LAW**

Based upon the Findings of Fact as contained herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:

1. Rate of return on rate base is the appropriate guide for the Commission to use in determining the lawfulness of the rates of Carolina Water and in fixing of just and reasonable rates for Carolina Water to charge its customers in South Carolina.
2. A fair rate of return on rate base for the operation of Carolina Water in South

Carolina is 9.05%. This rate of return is calculated using a capital structure of 50.11% debt and 49.89% equity, a cost of debt of 6.60%, and a return on equity of 11.5%. Based on the discussion and analysis of the Commission as detailed in this Order, these components of capital structure, cost of debt, and cost of equity and the resulting rate of return on rate base produce a fair and reasonable rate of return which the Company should have the opportunity to earn.

The Commission's analyses which give rise to the Conclusions of Law are contained in the discussions of Section III of this Order.

3. For the test year of September 30, 2010, the appropriate operating revenues, under present rates and as adjusted in this Order, are \$7,991,462, and the appropriate operating expenses, under present rates and as adjusted in this Order, are \$6,506,422.

4. Using the rate base as adjusted in this Order of \$24,005,206 and the return on rate base of 9.05% found to be fair and reasonable in this Order, the income requirement for Carolina Water is \$2,172,691.

5. In order for Carolina Water to have an opportunity to earn the return on rate base found reasonable and approved in this Order and to meet the income requirement, Carolina Water must be allowed additional revenues of \$1,268,844.

6. The rates approved in this Order are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of the Company.

7. Based on the adjustments approved herein and the increase in rates approved herein, the appropriate operating margin for Carolina Water on its South Carolina operations is 15.02%.

8. The Company's requested modifications to certain terms and conditions of service

in its rate schedule is in the public interest.

9. The Company shall institute the notification and reporting requirements with regard to customer service, water quality, and DHEC compliance as stated supra.

10. The appropriate bond requirement for the Company is \$700,000.

**IT IS THEREFORE ORDERED THAT:**

1. Carolina Water is granted the opportunity to earn a rate of return on rate base for its water and sewer operations in South Carolina of 9.05%.

2. The schedule of rates and charges attached hereto as Appendix A, which include the Company's proposed modifications, are hereby approved for service rendered on or after the date of this Order. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240.

3. Should the schedules approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.

4. Carolina Water shall maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A Water and Sewer Utilities, as adopted by this Commission.

5. The Company shall institute the notice and reporting requirements with regard to customer service, water quality, and DHEC compliance as stated supra.

6. Carolina Water shall post with this Commission a bond with a face value of \$700,000 to satisfy the findings in this Order within ninety (90) days of receipt of this Order.

7. Carolina Water shall report to the Commission no later than 6 months from the date of this order of mitigating measures, cost estimates and feasibility of remedies to water

service to Forty Love.

8. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

\_\_\_\_\_  
John E. Howard, Chairman

ATTEST:

\_\_\_\_\_  
David A. Wright, Vice Chairman

(SEAL)

## CERTIFICATE OF SERVICE

The undersigned employee of Elliott & Elliott, P.A. does hereby certify that she has served below listed parties with a copy of the pleading(s) indicated below electronically on the date indicated below

RE: Application of Carolina Water Service, Inc. for adjustment of rates and charges and modification of certain terms and conditions for the provision of water and sewer service

DOCKET NO.: 2011-47-WS

PARTIES SERVED: Nanette S. Edwards, Esquire  
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PLEADING: Proposed Order

October 6, 2011

  
Jackie C. Livingston, Paralegal